1812

1956

First National City Bank Monthly Letter

Business and Economic Conditions

New York, December, 1956

General Business Conditions

THE shooting at Suez has died down, but its repercussions are being felt around the world. The economic impact of the Middle East flare-up has been relatively mild in this country, although conflicting appraisals of the situation have added a note of uncertainty to otherwise favorable prospects for domestic business. Consumers have not stampeded to buy as they did in the early stages of the Korean War. Nor have business men shown signs of going overboard in building up inventories. The impact on prices has been limited largely to commodities directly affected by the closing of a major world trade artery. Thus, the tentative verdict of men and markets appears to be that the Suez situation, in its present dimensions, is not a dominant consideration in the domestic business outlook.

In Europe and the Middle East, the economic consequences are more serious. The military and political situation is still unsettled, but certain economic implications already are plain. The Suez Canal has been blocked to commercial traffic for an indefinite period; repairs to sabotaged pipelines will take time; and shipments of oil and other commodities must take the longer and costlier route around the Cape of Good Hope. Europe has lost a substantial share of its regular petroleum supplies and will be able to make up only a portion of that loss from Western Hemisphere sources.

CONTENTS

Estimates of this deficit range from 15 to 25 per cent of Western Europe's normal daily petroleum consumption. The implications of the shortage were summed up by the *Manchester Guardian* on November 22:

> Petrol rationing is only a foretaste of the full price that may have to be paid for the closing of the Suez Canal. Oil purchases from America will have to be paid for in dollars. A shortage of ships because of longer voyages around the Cape will interrupt the movement of imports and exports, and may lead to a reduction in output in some industries. A further cut in fuel oil consumption may be necessary, in which case short-term working and even unemployment might become widespread. If the canal can be restored to navigation quickly these difficulties may be short-lived. But a prolonged stoppage would have grave consequences throughout the entire economy.

In short, the closing of the Suez undermines the business boom in Europe, impairing fuel supplies and bringing fresh strains in international balances of payment. Current dollar earnings are being diverted and dollar reserves tapped to pay for Western Hemisphere oil. For the United States this implies some loss of markets for certain manufactured goods but an even greater stimulus to exports of coal and petroleum. Domestic crude oil production will have to be stepped up to replace the roughly 300,000 barrels per day formerly supplied to this country from the Middle East and also to meet European needs, insofar as the availability of tankers and transportation to port areas permits.

Over the longer run, the Middle East crisis, together with Soviet military action in Hungary, is apt to hold back further cuts in this country's defense spending and may eventually bring about increased outlays. Proposed emergency programs for supertankers or oil pipelines have not been put in motion, but if and when they are the extra demand will necessarily be piled on top of orders for steel plates, pipe, and structural shapes which already far exceed the capacity of the industry.

Price Stability

The absence of large-scale speculative price advances has been a heartening feature of the current situation. A wide variety of imported commodities normally passes through the Suez Canal and these shipments will now be disrupted and delayed, while transportation costs will increase. Nevertheless, the U.S. Department of Labor's daily index of spot prices of basic raw industrial commodities has risen only 7 per cent in the four months since the seizure of the Suez Canal in sharp contrast to the jump of 50 per cent during the first four months of the Korean War. Among the commodities affected by the Suez crisis, tin has shown a rise of 13 per cent while domestic crude oil prices have remained stable. Rubber prices have increased about 10 per cent. Such Far Eastern commodities as jute, burlap, copra, and tea have also advanced in price.

Wholesale prices in general have risen only slightly since mid-year, as declining farm prices have offset most of the price increases following the steel strike. In October, the consumer price index, largely reflecting a delayed reaction to last summer's increase in wages and wholesale prices, advanced to a new record, 2½ per cent higher than a year earlier.

One reason why there was no panicky bidding up of prices as the international situation deteriorated may lie in the widespread knowledge that substantial stocks were already on hand. Purchasing agents have generally been following conservative policies this fall, shortening up on commitments and trying to whittle down the near-record stocks of purchased materials. Behind these large private inventories lie the Government's vast stockpiles of strategic materials for use in a national emergency.

One commodity after another which had been hard to get has become more plentiful during the course of 1956. Apart from nickel and certain types of steel, few commodities are scarce in today's markets. A prime illustration is the announcement in November by the Aluminum Company of America that supply of aluminum had caught up with demand and that the industry was embarking on an intensive merchandising campaign to develop new uses and stimulate sales.

Sustained Industrial Activity

The improved supply of industrial commodities generally reflects expanded production of materials rather than slackening in the rate of use. Over-all industrial activity has been at a record rate this fall. November is expected to advance to a new high level, mainly because of the recovery in automobile production. In October, the Federal Reserve's seasonally adjusted index of industrial production (1947-49=100) was 145, the same as the revised September level.

Over-all industrial activity in October was only 1½ per cent higher than it was a year earlier, as measured by this index. On the face of it, this showing offers little to cheer about considering the heavy investments made to expand industrial capacity. A gain of this magnitude barely suffices to keep pace with the annual increase in the population.

October's production record was set, however, against the drag of low automobile production. A year ago, passenger car output was riding high; this October it was almost 40 per cent lower. Such a difference could directly account for roughly 3 points in the production index, and for perhaps twice that amount when the indirect influence of car and truck output on other industries is taken into account. In addition, a sizable volume of goods was produced for inventory in the fourth quarter last year, whereas this year's output appears to be geared more closely to actual demand. When these two factors are taken into account, the year-to-year gain in other types of production is, on the whole, closer to what one would expect in a growing economy.

Demand for Capital Goods

The capital goods boom, reflected in the indexes of machinery, instruments, and transportation equipment output, has been chiefly responsible for keeping the general level of industrial production high. Despite the heavy output of most types of producers' equipment, order backlogs have risen. Unfilled orders of machinery manufacturers increased nearly $4 billion in the year ended September 30 and transportation equipment producers added $4½ billion to their backlogs in the same period.

The strong demand for capital goods is not likely to subside soon. The basic forces which touched off the record-breaking capital outlays of the past year and a half are still at work. To be sure, the squeeze of costs against profits has become increasingly important in invest-

ment decisions. This squeeze has a deterrent effect on expansion where it signals a catching-up in capacity and an inability to pass increased costs along in higher prices. Also, it can work the other way, providing an incentive to cost-cutting investment.

By this time of year, corporate budgets for 1957 capital expenditures are beginning to firm up. A handful of spot checks of key firms and localities indicates that business men anticipate an increase in plant and equipment outlays somewhere in the neighborhood of 10 per cent. The largest individual segment of the capital expenditures picture fell into place last month when the American Telephone and Telegraph Company announced that the Bell System as a whole would spend $2½ billion on new plant and equipment next year, an increase of about 14 per cent over 1956.

Business and government spending on non-residential construction in 1957 will rise 8 per cent over 1956, according to the annual forecast by the U.S. Departments of Commerce and Labor. Industrial plant construction is expected to continue to expand, but only about 5 per cent above 1956. The building boom in shopping centers and stores appears to be subsiding; this activity will decline in 1957. However, the demand for office buildings, public utilities, and private institutional construction is still strong and is expected to rise 10 per cent or more. An increase of 12 per cent is anticipated in publicly financed construction, including schools and highways.

Although next year's capital outlays will be higher than the average 1956 level, this does not imply a rate much higher than that now current. Shortages of structural steel on the one hand and tight money on the other are causing some spreading out of expenditures. This will help to make the topping off in capital goods activity a long, flat crest rather than a sharply pointed peak.

Are We Going Too Fast?

The basic problem of the capital goods boom is simply stated, but not as simply answered: Are we trying to do too much too fast? Efforts to grow too quickly have unstabilizing effects; they lead to mistakes, miscalculations, and maladjustments. Carried to an extreme, they may end in lack of balance between productive facilities and consumer wants and in over-capacity in specific lines.

When the demand for capital exceeds the rate of saving, and productive facilities for capital goods are as fully engaged as they are now, inflationary pressures result. Some capital demand, some borrowings, and some projects must be postponed. At the same time, the community at large must be induced to lay aside more of its income, abstaining from consumption in order to finance growth. The solution of the problem requires attack from both sides.

Votes to Borrow

In the November election people voted on a total of 546 proposed bond issues to finance various state and local government projects – to provide benefits to war veterans and to build schools, roads, water and sewage systems, hospitals, libraries, city halls and courthouses. Voters in California authorized the State to borrow $500,000,000 to finance home-purchase loans to veterans; Lindsey, Ohio, voted to borrow $9,000 for a water system. In New York $500,000,000 for highways was approved; $100,000,000 for public housing rejected. Chehalis, Washington, turned down bond issues for a new city hall and fire truck but approved one for a swimming pool. Flathead County, Montana, approved borrowings for a new school but turned down a new courthouse.

The total amount voted on, according to *The Daily Bond Buyer,* was a record $2,657,042,457. The total approved – $2,449,289,557 – was also a record figure.

In placing these proposals before the voters the responsible state and local government authorities knew that borrowed money was not so easy to come by as it was a year or two ago and that interest rates were higher. Many voters also were conscious of these facts. Nevertheless, the proposals were offered and – for the greater part – approved. In voting to finance projects with bond issues people also had in mind that taxes, federal, state and local, are already pretty stiff; that the interest rates involved, while the highest in almost twenty years, are generally lower than the citizen himself would have to pay; and that some of the costs of capital projects can properly be deferred to be paid for over the years by the people who live to enjoy them.

To vote to authorize a school or water district, a county, city, or State to borrow is the right of the free citizen in a democratic society. This does not guarantee that the money will be forthcoming. The citizen relies on another democratic institution – the free market – to provide the money. Investment and commercial bankers competitively bid for the bonds, but, like any other merchants, they set as their benchmark of value what they can get from investors.

Here the voters for bond issues run up against another body of free citizens: people with savings to invest who have just as much right and responsibility to say yes or no as the voter did. In a rare case, the free market will veto an ill-considered bond issue that places too much burden on a municipality's stream of present and prospective tax revenues. In any case, the fact that so many States and municipalities want to borrow so much at one time makes interest costs higher for everyone. The offer of higher interest rates — exempt in this case from the federal income tax — invites more people to become investors, induces more saving, and thus makes it possible for States and municipalities to raise more money in this way.

Checks and Balances

It should be no surprise — considering also the vast demands for funds of home builders and industry — that prices of state and local government bonds weakened after the election. Because of unfavorable market conditions, some authorized bond issues are being deferred; in some other cases projects may be reconsidered or, where voters had specified a limit on interest cost, resubmitted at special elections.

This is the way, by a decentralized system of checks and balances, a free society tries to hold demands for labor and materials within bounds of supplies. Where people feel projects are absolutely essential they can make them possible by accepting higher taxes and reducing personal expenditures. Or they can vote to pay higher rates of interest. When projects can be scaled down in size, or put off into the future, demand for labor and materials is postponed from a time when these are scarce to a time when business is slack and labor unemployed.

Most people would rather maintain economic stability with freedom than try to achieve it with Federal Government bureaus controlling prices and wages, allocating scarce materials, and deciding among competing projects. If we give up the object of stability, and try to finance more than the economy can produce, the arbitrary hand of price inflation cuts our projects down to size.

Legislative changes can also be invoked to help the free market do its work. In New York, where upstate school districts plan to spend $314,000,000 on school construction during the next two years, Governor Harriman has appointed a committee headed by the State Comptroller to examine ways to ease financing costs. One idea is to issue bonds through a state school authority with the guarantee of the State to strengthen investment appeal. Another is to press Congress to apply the "conduit" principle to municipal bonds so that mutual funds could be set up to buy such securities and pass the federal income tax exemption on to the investor. This idea to broaden the market was endorsed in the President's Annual Economic Report in January 1955, but never has been acted on.

While such expedients can help in apportioning the available funds, they do not add to the total or detract from the force of the moral — not to try to finance more than the economy can produce.

More on "Poverty"

The response accorded the article on "Poverty in the Midst of Prosperity" in the November issue of this Letter has attested to the sensitive nature of the subject in the minds of many people. Indicative of the pervasive interest and feeling has been the number of "letters to the editor", some commendatory and others critical. Because of this divided reaction and the character of some of the remarks and evidence submitted, we are prompted to undertake a brief follow-up piece this month, citing certain passages in this correspondence with appropriate comment.

Before proceeding it might be well to recall what this is all about. As may be remembered, the discussion last month was concerned with oft-repeated charges that millions of Americans are scraping along on incomes too low to sustain a decent living. Taken as a text were two outstanding examples of such charges:

Adlai Stevenson's declaration last Labor Day, "I say it is wrong that 14,000,000 of our fellow Americans live today in families whose income is less than $1,000 a year. . . . Ugly patches of poverty and insecurity . . . still deny dignity, even decency, to the lives of almost one fifth of all American families."

Governor Harriman's assertion last year, "It is shocking to realize that there are still 8,000,000 families — one out of every five — with incomes under $2,000 a year. Minimum health and living standards cannot be sustained on that."

Without denying the existence of genuine poverty in this country, the article attempted to demonstrate the unreliability of the statistics generally presented as evidence, and to stress the need for better definition of terms and clearer recognition of qualifying factors in determining the dimensions of the problem. Boiled down, our major points included the following:

1. The figures are estimates based on sample interviews across the country, hence subject not only to the sampling errors inherent in such surveys, but also (and more serious) to the under-reporting characteristic of many income data.

2. A low income in any given year is not necessarily poverty where it is temporary and/or there are adequate savings or other resources.

3. Incomes are not properly comparable without consideration of environment. As everyone knows, a given cash income goes much farther on a farm or in a small town than in a large city. Likewise, it goes farther for a retired couple than for a family with several growing children.

We made reference to Federal Reserve Board surveys showing the large proportion of spending units with less than $2,000 a year money incomes that had some savings in the form of bank accounts, savings bonds, and similar assets, and that owned their own homes – in a high percentage of cases free from mortgage debt. The data showed also the considerable proportion that owned automobiles, and that had recently made a major household purchase, such as a washing machine or a refrigerator, a TV set, or furniture – yet the share of this group with consumer debt was lower than among families with higher incomes. This showing, it was suggested, is hardly consistent with the traditional concept of poverty.

A Sharp Retort

A reader, however, takes us sharply to task on all scores. While space limitations prevent full quotation of his letter, the following extracts will indicate the tenor of his remarks. Seizing upon an example we quoted from the *Wall Street Journal* of a retired businessman and his wife living in their own home in Florida on monthly expenses of $88 – well within their monthly Social Security check of $93.50 – he writes:

> You refuse to accept the definition of poverty employed by U.S. Senator Sparkman's committee, but you do not offer a definition yourself. Instead you expatiate a lot of nonsense about elderly couples existing on $88 a month! Try yourself and family to live adequately on that budget for one month! If after that experience you are not ready for economic, political, and educational change, then your I.Q. is on the level of a slave . . .
>
> You make much of under-reporting of income. That may hold for the rich tax evaders who can afford slick lawyers to detect loopholes. For the common workpeople under-reporting pertains to the outgo and not to the income. Their wages are publicly recorded for tax withholding purposes.
>
> . . . Your concluding sentence can be read as capital satire! It follows: "Government officials should never become so occupied with raising living standards for the unproductive that they tax away the incentive to produce for the working army on which the welfare of everybody depends."
>
> By unproductive I understand those who consume without producing, the essentially parasitic and kept classes. If the highly pecuniarily competent who are backing the current government and their greedy tax gatherers persist in squeezing the workpeople, the next election victory will be a response to a principle of justice and not primarily to a person.

Testimony from Another Quarter

The foregoing is – as the saying goes – certainly a "mouthful" and to reply fully would require an essay. By way of rejoinder, we quote from another correspondent whose comments are of quite a different character but much to the point. Coming from a small town in Maine rather than from a Wall Street bank, this testimony may carry more weight than anything we could say. He states:

> It was interesting to read your piece on "poverty" in the light of prevailing wage scales in this area. I welcome your attack on the statistical definitions.
>
> Although there are higher wages to be had at the Bath Iron Works and Sylvania in neighboring towns, the bulk of the jobs in this market town – gas station attendant, grocery clerk, and such – pay between thirty-five and forty dollars a week. In the case of one of the gas stations, it's a fifty-hour week, too.
>
> The vice president of a nearby bank, after twenty-two years of service, was paid sixty-five dollars a week.
>
> Most of these men, even those with two children, would be surprised and insulted at being labelled poverty-stricken. Their automobile is probably the largest expense, but it is very often a pickup truck which fits in with their pattern of living. Their housing is excellent generally, and may have stood them anywhere from three hundred to five thousand dollars for a three-bedroom house with a bath. Most include acreage and one or more farm buildings. A couple of dozen chickens provide eggs and fowl. A couple of sheep keep the grass down.

He goes on to say:

> Other generally owned accoutrements are a boat, an outboard motor, a shotgun and rifle, fishing tackle, and, if on salt water, perhaps a half-dozen lobster traps. The principal expense is for licenses and an occasional box of shells. May, trout; June, bass; July, lobsters; August and September, all the foregoing plus berries; October, partridge and pheasant; November, deer; December, ducks and squirrels; January, rabbits; February, ice fishing; March and April, get ready for May.

As our correspondent conservatively puts it, "It's a recreational pattern that a good many city people would give their eyeteeth for, and to have it all within a radius of 15 miles, unthinkably good. . . . The need for money beyond a small wage is not great."

No one would claim that this situation is typical. Nevertheless, with climatic variations, it applies in some degree at least in many places. Maine is not the only State where people can have a little place and raise chickens and grow

some vegetables. The chief point is one stressed in our article: "poverty" and "low income" are not interchangeable words – even though speechmakers often use them that way.

Rebuttal — Continued

As for other criticisms in the first quotation above, a few words of comment must suffice.

The contention that under-reporting of income holds only for the "rich tax evaders" and not for the "common workpeople" can be dismissed summarily. True, wages are recorded for tax-withholding purposes by employers reporting to the Internal Revenue Service. But, as everyone must know from personal observation, there are countless cases of self-employed people and casual workers whose full earnings never get into the records. The amount of unreported income must run into the hundreds of millions – if not billions – of dollars, and introduces a substantial element of error into income surveys based on sample interviews. It can hardly be supposed that people who are withholding the full facts as to their income from the tax authorities are going to report them to some interviewer who comes to their door.

This, incidentally, constitutes one of the strongest arguments for indirect taxes, including sales taxes, as a supplement to the income tax, to reach those who otherwise escape paying their fair share of the cost of government.

While the sense of the concluding two paragraphs of the first quotation is not entirely clear, one detects the underlying philosophy of the writer in his apparent identification of the "highly pecuniarily competent" with the "essentially parasitic and kept classes." Passing over the question of the economic contributions to society of the financially successful, and ignoring the implications of income taxes running to 91 per cent in the top bracket, we suggest that our critic's concern with the burden of taxes on the workpeople – a concern manifested again and again in our correspondence – detracts nothing from the force of the sentence quoted from our text.

If "greedy tax gatherers persist in squeezing the workpeople" it is because government outlays have become so vast they can no longer be met by the relatively well-to-do, but must be spread over the great body of taxpayers. It may be doubted that the industrious, thrifty, and independent citizens of the community described by our Maine friend, and others like them over the country, would subscribe to the dictum of our critic – "Your concluding sentence can be read as capital satire."

Implications for Minimum Wage Legislation

Finally, as we are reminded by our Maine correspondent, this question of setting up arbitrary income standards has broad ramifications, including implications for minimum wage legislation. We quote further from his letter:

> If "poverty" is a relative thing and subject to contextual definition, so indeed is the minimum wage. I do not see that a single standard set in Washington can be appropriately applied to all sections of the country.
>
> Two small examples of its inappropriateness here: A company is formed to assemble and market high-quality braided rugs. The braid is farmed out to housewives at a piecework rate; the finished braid is put together into rugs in an old sail loft, ideal for the purpose. The housewives are delighted to have some cash income. The company gets one good outlet in each state . . . it is hard put to it to keep up with demand. The minimum wage people objected to the piece rate as inconsistent with the dollar minimum wage in interstate commerce. The company's margin was so reduced that it was forced to suspend operations.
>
> The inhabitants of Islesboro in Penobscot Bay formed a twine-making "cooperative" to provide some cash income. The equivalent in hourly rates had to be set low in order to compete with Scottish fishnets at the devalued rate of exchange. The minimum wage wrote the end of this one too. In neither case did any of the workers feel that they were underpaid – a rare enough occurrence in itself – but both groups are "technologically unemployed."

Here, as pointed out by the writer, are involved no "sweatshops" or threat to "decent" living standards. A group of people in a community where modest incomes and a good living are not incompatible, banded together to make a little extra money which they could use for gratifying additional wants or for laying aside for a "rainy day." The consumer presumably benefited by getting something at a price lower than he might otherwise have paid. Admittedly, these examples are not the whole answer to the question of the minimum wage. They do suggest, however, some of the problems and demonstrate the importance of not raising too fast minimum rates whose appropriateness varies so greatly from one situation to another.

New Help for Small Business

The welfare of the "little fellow" long has been a leading concern of our democratic form of government. The small business man is the traditional symbol of individualism and our free enterprise system. It is little wonder then that the Federal Government has tried for many years to protect and assist small business. A wide variety of methods have been tried, such as curbing monopoly or other unfair restraint of trade, permitting resale price maintenance ("fair trade"), making direct loans, channeling

defense contracts, and supplying technical and economic information. A close check on small business problems is maintained by the Small Business Committees of the Senate and the House of Representatives, while the Small Business Administration and other departments and agencies in the executive branch have continuing responsibilities in this field.

President Eisenhower, recognizing the difficulties facing small firms, last spring appointed a special Cabinet Committee on Small Business with Dr. Arthur F. Burns, his chief economic adviser at that time, as chairman. The cabinet committee, in a report released August 7, acknowledged that problems exist, but it refused to go along with those who insist the small business man is being driven to the wall in these days of record business activity. The report recommended certain types of tax relief, reduction of reports and red tape, improved procurement, and stepped-up anti-monopoly action.

Drawing on the committee's recommendations, the President is preparing a new program which he will present to the Congress in January. Leaders of both parties have publicly stated that small business problems should get prompt attention in the new Congress. It is timely, therefore, to consider the obstacles impeding business growth and to assess proposals for overcoming them.

What Is Small Business?

Formulating policies to help small business is difficult. Inefficiency should not be subsidized. Large companies which have risen to the top in fair competition should not be subjected to arbitrary restrictions. And added difficulties arise simply because it is hard to define exactly what is to be helped.

The Small Business Administration defines a small business as one independently owned and operated and not dominant in its field. The Defense Department, in parceling out defense contracts, sets 500 employes as the dividing line between large and small. SBA has been criticized by both Senate and House Small Business Committees for going along with the Pentagon's 500-worker figure when trying to get defense business for small manufacturers. The committees feel that a single dividing line for companies making anything from tanks to bobby pins is illogical and should be replaced by an industry-by-industry definition.

Despite difficulties of definition there is no doubt that the great bulk of all businesses fall somewhere in the elusive category of "small business." President Eisenhower puts the number of such firms at approximately 4,000,000 — about 95 per cent of the total business population at the beginning of this year. These firms are unofficially estimated to employ more than 25,000,000 people and to account for about one-third of national output of goods and services.

Most of the neighborhood stores and service establishments with which we deal every day are small businesses, representing the efforts of some individual to make his own way in the world. There are always people who do not care to work for others but prefer to risk their time, their ingenuity, and their savings in an enterprise of their own choosing.

Some of these small business men are qualified and experienced; others are not. Some small businesses are highly successful; others survive but return the proprietor less than he could earn in an outside job. A great many fail. During the postwar decade, 1946-55, an average of 292,000 firms went out of business each year and 430,000 changed hands. Yet each year, on the average, 393,000 new businesses were started — a remarkable tribute to the unflagging optimism and enterprise of the American people. As one commentator has put it: "The inalienable right to lose one's shirt is still highly cherished."

Small Firms' Problems

The problems of small business are complex and varied. Because of their interrelation it is hazardous to try to isolate them. A better approach is to examine the difficulties that crop up in those broad areas that greatly influence small firms' ability to get started and grow. These areas are big government, big labor, and big business.

As to the first — big government — one of the most pressing problems of small business is the heavy burden of federal taxes. These levies hit small business two ways: First, they infringe on ability to plow back profits into the business. Retained earnings are normally the principal source of money for the expansion of a successful business. The Horatio Alger story of the Ford Motor Company — which, beginning with $28,000 in 1903, was worth nearly a billion dollars by 1930 — could not be repeated under the present-day tax structure. Second, the small firm looking to outside sources finds wealthy backers few and far between. Their numbers have been decimated by the wealth-redistributing effects of twenty-four years of steeply progressive income and estate taxes.

Additional problems of small business stem from the fact that the Federal Government has

become the largest single purchaser of goods and services produced by the private economy. A substantial part of these purchases consists of intricate military items which cannot be efficiently produced by small firms, except for parts on a subcontracting basis. Moreover, while the Defense Department spreads out its orders as far as possible, government orders are subject to annual appropriations and do not provide a secure basis for business growth.

Government operation of such things as ice cream plants, laundries, and false teeth factories is another source of trouble for small business. The U.S. Budget Bureau reported last May that the Government was operating nearly 20,000 commercial-industrial activities in competition with private industry. Progress has been made but much remains to be done.

Another headache in the big government area is the mountain of paper work required of a small business man, partly in connection with the work he is supposed to undertake as an uncompensated collector of taxes levied on employes and customers. At present an employer must file five reports a year with the Internal Revenue Service on the earnings of his employes. He must segregate funds for taxes, file reports, and hold his accounts open to audit. Despite the efforts of the U.S. Budget Bureau to eliminate unnecessary and overlapping surveys, numerous statistics and reports are required of the harassed small business man.

All this, of course, is without even considering the myriad rules, regulations, and edicts promulgated by government, state and local as well as federal, which tell the business man everything from the kind of language he can use in advertising his product (Federal Trade Commission) and the working conditions he must provide if working on federal projects (Labor Department) to the kinds of ingredients he can put in his product (Food and Drug Administration) and the level of wages that must be paid (Labor Department).

Big Labor and Small Business

Big labor often saddles the small business man with another set of problems. These involve the wage-price-cost squeeze.

The upward trend during recent years in the cost of doing business has particularly affected earnings of smaller companies. These companies often are marginal producers that are less able than larger companies to pass on increased costs in higher selling prices.

Small and medium-sized businesses during recent years have been forced, because of "patterns" of higher wage rates and other benefits agreed on by industry leaders, to accept similar terms which many of them could not afford. The result has been a rise in their costs beyond what could be recouped by higher selling prices and a squeeze on often narrow profit margins.

This point was driven home by Harold J. Ruttenberg, once an organizer for the United Steelworkers and now a small business man, in the March 23 *U.S. News & World Report*:

> . . . unless the unions adopt a realistic viewpoint toward the small manufacturers – by that I mean companies employing 100 to 500 people, or doing 1 million to 10 million dollars' volume – unless the unions adopt a policy of co-operating with them to increase their efficiency, they are going to negotiate the small manufacturers out of existence or into divisions of large companies.
>
> The unions are a prime mover in the tremendous merger programs that have been under way in the last several years in American industry.
>
> They force a small company over the horizon, over the hill, where they've got to go and get under the umbrella of a big company by becoming a division of it – selling out.

Big Business and Little Firms

The third broad area influencing small business' ability to grow and prosper is big business. There is no doubt that a small firm suffers some natural disadvantages such as lack of ability to command quantity discounts and to gain the economies that flow from large-scale production and shipment. Another disadvantage frequently cited of small business *vis-a-vis* big business is availability of credit. Said the head of a small midwest seed company in *Newsweek* of October 22: "Very little new credit is available. A man starting a new business today would almost certainly have a tough time."

One trouble is that small business men often do not distinguish between lack of credit and lack of capital. There is no doubt that big, established companies have readier access to the market for long-term capital funds than do new, little firms. Short and intermediate term credit from banks, on the other hand, is extended to both big and small businesses – if the companies are creditworthy and the purpose of the loan is sound. Most banks are themselves small businesses and can lend only in a small way. Indeed, they not infrequently need participation from city correspondents to help them cover needs of local industry and merchants. Beyond this, all prudent bankers like to spread out their risks and are required to do so by legal loan limits. A survey conducted by the Federal Reserve Board indicated that as of October 5, 1955, member banks of the Federal Reserve System had outstanding

more than 1,000,000 individual business loans to borrowers with total assets of less than $250,-000. Refuting the idea that banks, under pressures of credit demands from larger firms, have been cutting back on small business credit, the American Bankers Association made a spot check of 78 banks and found that business loans of less than $50,000 rose 14½ per cent in the year ended August 31, 1956.

Big companies clearly have an edge over little firms in other ways. The pace of technological change has been accelerating. Large, well-financed firms can undertake costly research and development programs to keep pace with industrial innovation. Most small firms, as the cabinet committee noted, cannot do this. Another advantage is the growth of radio, TV, and other mass media which favors nationally known brand names and complicates the marketing problems of small business.

On the other hand, the small business has some advantages of its own over the corporate giant. Because it is in closer touch with customers, employes, and supply sources, for instance, a small business can often do more of a custom job, attracting customers on the basis of specialty products, quality, and personal services, rather than price. A small firm is usually more flexible and can switch production more readily to meet changing market conditions.

In presenting advantages of big companies over little ones it should be remembered that in many instances the activities of little concerns supplement rather than compete with those of big concerns. This was brought out in a recent study by the duPont Company. Citing the vital interdependence of big and little business, the company noted that more than nine-tenths of its 75,000 customers and 30,000 suppliers were small firms, and added:

> Contrary to popular belief, the bigs and the littles do not compete directly for the same business. The bigs do the jobs for which they are best equipped – volume production, large scale research, and development. Only companies with large resources can participate in those fields requiring heavy investment in development and productive facilities. The small companies, on the other hand, excel in processing, converting and distributing the products of big business.

The President's Proposals

The many problems of small business in dealing with big government, big labor, and big business are obviously complex. President Eisenhower believes, however, that some of them can be at least reduced with help from the Government. To accomplish this he has promised to present to the Congress a legislative program based on the following cabinet committee recommendations: cut to 20 per cent the present 30 per cent federal taxes on a corporation's first $25,000 of income; permit accelerated depreciation on used machinery purchases up to $50,000 a year; give taxpayers the option of paying death taxes over a period of up to 10 years in cases where the estate consists largely of investments in closely-held businesses; and allow corporations with, say, 10 or fewer stockholders the option of being taxed as if they were partnerships, thus enabling them to avoid being taxed twice on their earnings. The cabinet committee estimated these tax measures would result in a revenue loss to the Government of $600 million in the first year.

Other legislative recommendations being worked up by the Administration would: boost to $500,000 from the present $300,000 the ceiling on securities issues exempt from full registration with the Securities and Exchange Commission; enable the Justice Department to scrutinize more closely proposed mergers that might jeopardize the competitive position of little firms; and extend the life of the Small Business Administration beyond its termination date of next June 30.

The President has already taken some actions suggested by the cabinet group which did not require Congress' approval. He has called for a "comprehensive review" of government procurement policies aimed at increasing small business' share of federal purchases and insuring that a small concern's need for so-called progress payments on partly completed government work won't handicap its chances of getting contracts. He has also asked the Commerce Department and the Small Business Administration to draw up, early next year, programs to keep small business abreast of latest advances in technology and distribution methods. The Budget Bureau has been instructed to lessen the burden of paper work on small business.

No Cure-all

These actions and recommendations, salutary as they might be, are no cure for all the ills of small business – as the President and his cabinet committee are well aware. There are some problems that can't be solved simply by issuing a federal edict or by passing more laws. How can you legislate away the tremendous demands placed on the managerial know-how of the small business man today? A small business man often has to be able to sell, run a production line, negotiate with a union, handle adver-

tising and promotion, keep the books, pay all kinds of taxes, keep solvent, and stay abreast of the endless requirements of federal, state, and local government rules and regulations.

Doing all this requires extraordinary ability. It is a rare man or woman who possesses the full collection of talents.

A recent Dun and Bradstreet study gives an interesting analysis of why businesses fail. As can be seen in the table below, more than nine out of 10 businesses failed because of inexperience or incompetence.

Why Businesses Fail

Apparent Causes	Per Cent of Total, Year Ended June 30, 1956
Neglect	4.5
Bad Habits	1.2
Poor Health	2.5
Marital Difficulties	0.5
Other	0.3
Fraud	2.2
Inexperience	90.9
Inadequate Sales	45.8
Heavy Operating Expenses	7.0
Receivables Difficulties	9.3
Inventory Difficulties	8.3
Excessive Fixed Assets	8.0
Poor Location	3.2
Competitive Weakness	21.0
Other	4.6
Disaster	1.6
Reason Unknown	0.8
Total	100.0

Source: Dun & Bradstreet. Note: While the percentages in the broad categories add to 100 per cent, the sum of the specific causes may exceed the total for the category because some failures are attributed to a combination of specific causes.

The Sum-up

In searching for solutions to small business problems it is well to keep in mind that there are limits on what can be accomplished. Programs that would help some businesses would be of no benefit to others. It is difficult, for instance, to develop remedies that will help a small retailer get started and grow, and, at the same time, will prove beneficial to a small steel company. Aid to an inefficient business man who does not know his costs may damage a more deserving competitor.

In this country, any man who thinks he can build a better mousetrap is free to do so – regardless of his qualifications for the job. This freedom, however dearly it is cherished, cannot carry with it any guarantee that each business will succeed. The Chamber of Commerce of the United States in its booklet, *Small Business: Its Role and Its Problems* neatly sums up the point this way:

> Freedom implies the freedom to take a chance. A free society provides freedom of opportunity but does not guarantee success to all who enter. Success depends primarily upon judgment, managerial skill and experience. We should not expect all businesses to be able to live. Unless inefficient, high-cost firms are eliminated by competition, our economy will lose its dynamic character, will stagnate and decline.

Government efforts to lighten the tax load, cut down required paper work, and eliminate competition with private firms will help clear away some of the obstacles in the path of small business. In some cases, however, the very problems the Government is trying to solve can be directly traced to the Government itself. Taxes provide a good example. Money for expansion is one of the biggest headaches of small business. If the Government would curtail its spending and range of activities and reduce tax rates, small business would get a real lift. Appropriating tax revenues to lend to small business is no answer. Government loans make small business the dependent of government, and no longer an expression of the self-reliance of an enterprising citizen exploiting opportunity in a free and competitive society.

Probably the most important contribution the Government can make to the economic health of small business, as recognized by the cabinet committee, is to pursue monetary, fiscal, and housekeeping policies that foster sustained expansion in over-all business activity without contributing to price inflation. All sizes of business would benefit from such policies. The importance of this was demonstrated in 1955. There was a net increase of 63,000 business concerns – more than in any year since 1948, which marked the end of a period of rapid growth to make up for reductions during World War II. It reflected last year's record economic activity which followed tax reductions and was achieved with relative price stability.

Small business serves as a dynamic influence in our free enterprise system. The country needs little as well as big business. To the extent that sound steps can be taken to strengthen the development of small business, the interests of the whole country will be served.

The Cost of Depreciating Money

In Germany before the first World War, 40 billion marks of mortgage loans were outstanding – calculated to represent about one-sixth of the German national wealth. By 1923, when the mark had depreciated to a point where it took 42 billion of them to equal one U.S. cent, these loans were practically worthless. In a word, inflation gave away to debtors the wealth of creditors. It destroyed the provident middle classes, wiped out the pool of loanable funds, and erased every sensible reason for saving – for laying aside any portion of income for lending at interest. Speculators in commodities,

land, and foreign currencies offered fantastic rates of interest for borrowed funds, but little was forthcoming. People, to beat rising prices, spent their money as fast as it came in. They had to, for survival. Thus the paradox that the more money the Government printed the scarcer it became for would-be borrowers.

The German experience with explosive inflation during and after World War I is not unique. It was repeated in a number of countries in World War II.

Since World War II, slow-burning inflation has been the order of the day, afflicting almost the entire world. This is due mainly to political pressures to sustain full employment at constantly rising wage levels. One hears more and more competent observers projecting this drift indefinitely into the future, warning that "we are in a long-term cycle of inflation" or that "we shall experience a rising price level for the rest of our lives." There may be interruptions, we are told, and the average rate of rise in prices will be modest – possibly no more than two or three per cent a year.

Two or three per cent a year, on the average, has seemed quite harmless to many political leaders and economists. It does not seem harmless to savers trying to accumulate resources for retirement, education of their children, and family emergencies. They have been alerted to their perils by noting how their past savings have depreciated in real value and by the many predictions that the future will hold more of the same. They want better returns, and governments, with greater or less reluctance, have submitted to their demands and let interest rates rise, recognizing that a nation that systematically steals away the citizens' savings is inviting an uncontrollable holocaust of inflation.

The Point of No Return

Progressive inflation has been a world-wide phenomenon, as the following table suggests. The table shows for 16 countries the depreciation of money since 1946 as measured by official cost of living indexes. If the depreciation is converted to an annual rate, compounded, as the third column of the table shows, the saver has a measure of his point of no return – the annual rate of interest which he would have had to receive, and reinvest at compound interest, to have the same amount of purchasing power now as he had in 1946.

Rates of interest available in 1946 were artificially depressed by "cheap money" policies in most countries, and did not give the saver compensation for the depreciation in store for him. Switzerland, which offered 3.1 per cent on government bonds, was an exception, and the fact that the conservative investor in Switzerland has on the whole been better treated than elsewhere has something to do with the fact that interest rates in Switzerland today are the lowest in the world.

Rates of Interest and Depreciation of Money

Country	Indexes of Value of Money* 1946	Indexes of Value of Money* 1956‡	Annual Rate of Deprec. (comp'd.)	Rates Offered on Gov't. Bonds† 1946	Rates Offered on Gov't. Bonds† 1956‡
Switzerland	100	86	1.5%	3.10%	3.23%
Germany	100	72	3.2	n. a.	4.90
India	100	72	3.2	2.88	3.98
United States	100	71	3.4	2.19	3.27
Venezuela	100	70	3.5	n. a.	3.63
Netherlands	100	67	4.0	2.99	4.10
Canada	100	65	4.2	2.61	3.88
South Africa	100	65	4.2	2.89	4.75
Sweden	100	65	4.3	3.01	3.74
United Kingdom	100§	65	4.6	2.76§	4.86
New Zealand	100	59	5.2	3.01	4.73
France	100¶	58	6.5	4.26¶	5.48
Mexico	100	47	7.4	10.44	10.12
Australia	100	46	7.5	3.24	5.04
Brazil	100	26	12.7	n. a.	12.00
Chile	100	5	25.3	9.22	13.82

Note: depreciation computed from unrounded data. n.a. not available. *measured by rise in official cost of living or consumers' price index. ‡latest month available. †except for mortgage bond yield in Germany, commercial paper in Venezuela and Mexico, and commercial bank loan rate in Brazil and Chile. §1947. ¶1948.

In most countries, the saver of ten years ago has suffered serious losses in purchasing power; rather more than the table would indicate since interest income is often subject to taxation that waters down the rate and retards the working of compound interest. In the United States, for example, assume a capital sum invested ten years ago at 3.4 per cent, with all interest reinvested at the same rate. This sum would have grown enough in nominal value to keep up with the average rate of depreciation of the dollar only if the interest were free of income tax. A person in the 20 per cent income tax bracket would have required a taxable interest rate of 4.3 per cent; in a 40 per cent bracket 5.7 per cent; in an 80 per cent bracket 17 per cent. And all this simply to hold even with the depreciation of the dollar and avoid actual loss.

A Sorry Chapter

This has been a sorry chapter for the lender of money at interest. Today's higher rates help, but they will still leave the saver falling behind in the race unless the price record of the next ten years is better than it has been over the past ten. Of this there is promise, for the rise in interest rates itself is a reflection of a greater sense of discretion by government central banks and treasuries in creating money. Politicians who want lower interest rates must get them the hard way – by curtailing government expenditures and income tax rates, stopping the upward price drift, and letting the loan capital of the people grow.

End

O

RS

York

ANAMA

7a.
10-11
posición
RABIA

RE
re
y
deo
LA

Capilla
dia
bo

in U.S.A.